SUBMISSION REGARDING THE PROPOSED CHANGES TO THE R&D TAX INCENTIVE BILL

BioMelbourne Network
Progressing BioIndustry

ABOUT THE BIOMELBOURNE NETWORK

Our mission is to foster the development of a technologically advanced, innovation-driven and sustainable health industry. We are a not-for-profit, industry-led membership association; our 180 members encompass biotechnology, medical technology, pharmaceuticals and health innovation companies in Victoria. We play a critical role in connecting clinicians, researchers, finance and industry. BioMelbourne Network supports and promotes the growth of the sector's infrastructure, and facilitates the development and commercialisation of new drugs, devices, diagnostics and digital health technologies.

KEY POSITIONS AGAINST ELEMENTS OF THE BILL

The following describes our concerns and opposition to the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 (the Bill), introduced to the House of Representatives on 5 December 2019.

The R&D Tax Incentive (RDTI) has been a highly valued program designed to support innovative R&D undertaken by Australian businesses. It is vitally important to the Health Industry, which includes pharmaceutical, biotechnology and medical technology companies. Our members' companies range from early & mid-stage entities (SMEs) developing innovative products, through to large companies that have commercialised and are manufacturing and selling products in Australia and overseas.

All continue to undertake R&D and clinical trials to establish new, innovative, high value products and new intellectual property. Today, Australia's Health Industry is a vibrant, active sector in which high quality research from our universities and medical research institutes is further developed and commercialised by highly skilled people. Products can benefit the health of all Australians, create wealth (through profits on commercialisation taxed and returned as dividends), and ensure increasing numbers of skilled jobs.

IMPORTANCE OF RDTI

Shallow capital markets in Australia contribute to inherent risk and thus the difficulty of establishing companies in our sector and enabling their growth. This creates pressure to export intellectual property early. The RDTI provides an important additional source of financing that delays this export.

For larger local and international companies, the decision to invest in manufacturing, conduct collaborative research and clinical trials is based on cost and quality factors. Again, the RDTI has been shown to be a significant factor in retaining research and clinical trials here and attracting clinical trials from offshore. Outcomes are significant economic, employment and healthcare benefits.

IMPACTS OF PROPOSED CHANGES TO RDTI

The changes proposed in the Bill will reduce opportunities for the success of this sector as measured by growth through new investment, increased skilled employment, access to new and advanced therapies through clinical trials and increased manufacturing. The negative impact on employment is particularly concerning given the focus on increasing numbers of STEM trained graduates.

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UNFORSEEN CONSEQUENCES

BioMelbourne Network remains very concerned that, contrary to the Government's intentions, the proposed changes will have unforeseen consequences that will not stimulate R&D and will not improve the quality of R&D conducted, but <u>will reduce the incentives</u> for Health Industry companies to invest in R&D. Impact on jobs, growth and health outcomes are described.

1. **REDUCED SUPPORT FOR R&D DUE TO THE BUDGET GAIN OF $1.8B OVER THE CURRENT FORWARD ESTIMATES PERIOD 2019/20 TO 2022/23**

   The Budget Gain will be taken back into consolidated revenue and not redirected towards supporting R&D.

   This is an unwarranted cut to R&D funding in Australia. Any changes to the allocation of R&D funding should be redirected into specifically supporting development and commercialisation of innovation across Australian industry, including the Health Industry.

   > *<u>IMPACT:</u>* Australia will continue to move down the OECD rankings of business spend on R&D from 1.79% in 2017-18, well below the OECD average of 2.37% for developed nations.
   >
   > Small companies that depend on the RDTI will grow more slowly and will license their intellectual property to offshore companies earlier, losing opportunities for local growth, including for new highly skilled jobs. Large companies will have less incentive to bring research activity, clinical trials and investment here.

2. **COMPLEXITY OF PROPOSED AMENDMENTS: FLAWED INCENTIVE OF SCHEDULE 1 ("INTENSITY MEASURE"), FOR COMPANIES WITH TURNOVERS >$20M.**

   Australian companies are negatively impacted compared with foreign-owned companies, since their total local expenditure (including R&D, clinical trials, manufacturing, sales and marketing) is included as part of Overall Business Expenditure, whereas foreign companies only report on Australian expenditure, which may not include significant local costs, such as manufacturing.

   > *<u>IMPACT – LOSS OF AUSTRALIAN MANUFACTURING, LOSS OF SKILLED JOBS:</u>* instead of manufacturing locally, Australian companies wanting to increase their Intensity Measure, would set up manufacturing entities offshore.
   >
   > This way, the non-R&D manufacturing expenditure that is currently part of their Overall Expenditure, is now in a separate entity in a lower cost off-shore country.

   In addition, the calculation of the intensity measure [R&D spend/Overall Business Expenditure] is based on annual expenditure. But this is not known until after the end of the financial year.

   > *<u>IMPACT ON PLANNING:</u>* a company cannot budget and plan for the following year, because it does not know what its benefit, and hence incentive, will be from the RDTI.

3. LACK OF CLARITY ASSOCIATED WITH CLINICAL TRIALS

Clinical trials require use of organisations and specialist advisors who are not direct employees of the company but are integral to the process and success. These include contract research organisations, regulatory experts, manufacturers of the products to be trialled, hospitals/research organisations.

> *IMPACT ON PEOPLE, JOBS, INVESTORS:* The lack of clarity regarding expenditure associated with clinical trials leads to uncertainties regarding the capacity to fund this work and the additional capital to be raised, from whom and when.

4. IMPACT OF POLICY INSTABILITY ON AUSTRALIA'S INTERNATIONAL COMPETITIVENESS

For pre-revenue companies, the R&D Tax Incentive continues to be a "life-line." R&D is the basis for new products, it creates new jobs and attracts new investment. SMEs below the $20M threshold rely on the cash offset to help fund high risk R&D projects.

For companies above the $20M turnover threshold, it is another source of funds that enables them to continue their R&D programs, leading to new products, new manufacturing capabilities and new skilled jobs. It also attracts multinational companies to invest in R&D, clinical trials here and hence export-dependent jobs.

The RDTI enables our Health Industry to retain its high quality outputs, remain internationally competitive, thereby attracting and retaining highly skilled people.

> *IMPACT OF COMPLEXITY & FREQUENT CHANGES IN POLICY:* It is well known that frequent modifications reduce business expenditure on R&D for reasons that include businesses and investors being unable to plan ahead.
>
> It is very important that any proposed changes keep the program uncomplicated, are not retrospective, and provide predictable and stable benefits to companies.

5. TAX OFFSET RATES UNDERMINE BENEFITS OF RDTI FOR SMALL COMPANIES

The proposed measures effectively reintroduced in this Bill will reduce the available tax offset rates for companies.

> *IMPACT:* For Health Industry companies with turnovers less than $20M, this will be a reduction from 43.5% to 41% (ie their corporate tax rate plus 13.5% incentive component). This is a further erosion of the RDTI that was originally 45%, before being reduced to 43.5%.

6. PROPOSED ENACTMENT OF CHANGES RETROSPECTIVELY FROM 1 JULY 2019

> *IMPACT:* for the current financial year, companies have budgeted for an RDTI based on the current RDTI. For a company expecting a refund of, for example, $1.305M, this would now be $1.230M, a reduction of $75,000. This is equivalent to one person, or one part of a person's job. For small companies, this one person could be vital to the clinical trial being planned to start in the current financial year.

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The BioMelbourne Network is very concerned that the Bill will reduce opportunities for the ongoing success of the Heath Industry sector. Australia needs a stable, relatively uncomplicated and competitive RDTI that will support a healthy, growing R&D sector. With this, our SMEs and large companies will continue to commercialise and deploy new products and methodologies that positively impact the health of Australians, will increase skilled, STEM-based jobs, attract new investment and grow the sector, and demonstrate our global leadership and competitiveness.

KEY DESIRABLES UNDER A STRENGTHENED TAX SCHEME

We welcome the opportunity to engage with the Government to ensure a strengthened RDTI based on the following:

1. Reduced complexity and stable policy, with no retrospectivity.
2. Financial support for the R&D sector is maximised by using savings from the RDTI for Government programs that support development and commercialisation.
3. Tax offset rates remain at 43.5% for companies with less than $20M turnover, and these are not tied to corporate tax rates.
4. Ensure clarity of costs that can be claimed under the RDTI for clinical trials.
5. Ensure the Intensity Measure does not negatively impact Australian companies.

Submission to the Senate Economics Legislation Committee on the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill* 2019

This collective submission is made by Research Australia, Medicines Australia, AusBiotech, MTAA, the BioMelbourne Network, AAMRI and LSQ. In short, we represent innovation in health. Our combined membership conducts most health-related research and development (R&D) activities in Australia with the objective of discovering and delivering new health outcomes and a better health system for Australian patients and the world. This membership includes universities, research institutes and small, medium and large companies.

We are opposed to the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill* 2019 (the Bill) and call on the Senate Committee to recommend the Senate reject the Bill. The amendments are poorly designed and are based on the false assumption that the R&D Tax Incentive (R&DTI) does not lead to additionality and spillovers. A recent report commissioned by AusBiotech has demonstrated the significant additionality effects of the R&DTI for our sector.[1]

The Coronavirus has exposed Australia's reliance on one major export partner, China, for three of our major exports: minerals, tourism and higher education. Such a concentrated reliance on one export partner and a few exports is unparalleled in the developed world, and it is a situation we need to change dramatically by creating a more innovative and diverse economy that exports a range of goods and services to the world.[2] This means supporting

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[1] AusBiotech and Evaluate, 2019, R&D Tax Incentive: Additionality and spillovers for the life sciences industry; https://www.ausbiotech.org/documents/item/606

[2] See for example, the *Atlas of Economic Complexity*, developed by Harvard University, which rates the complexity of Australia's economy as the 93rd most complex economy in the world, behind Morocco, Uganda and Senegal. *'Australia ranks as the 93rd most complex country in the Economic Complexity Index (ECI) ranking. Compared to a decade prior, Australia's economy has become less complex, worsening 22 positions in the ECI ranking. Australia's worsening complexity has been driven by a lack of diversification of exports… Australia is less complex than expected for its income level. As a result, its economy is projected to grow slowly.' Accessed on 26 February 2020 at http://atlas.cid.harvard.edu/countries/14*

the companies in Australia, both small and large, that are engaging in research and development, creating new jobs and opportunities and diversifying our economy. These are the companies that utilise the R&DTI and which will be disadvantaged by the proposed changes.

The R&DTI provides an excellent mechanism for market forces to determine where and how R&D investment dollars should be invested. It has been highly effective at allocating scarce investment into areas where Australia and its research community have strengths, particularly in health and medical research and innovation. R&DTI is a more effective and predictable system for incentivising investment in small and large businesses than other mechanisms such as grant schemes, which are less predictable and tend to be targeted to deliver a specific policy outcome, rather than encouraging market led investment.

The current Bill initiates a new calculation of the refundable component that will result in a 2.5% lowering of the refundable component for most, if not all, life sciences companies. Under the Bill, the calculation will provide a 13.5% benefit to the applicable corporate tax rate. For the start-ups in our sector, that are 'pre-revenue' and not yet paying tax, this is a cut that directly reduces the amount of R&D they are able to undertake.

The Intensity Measure directed at large companies will reduce the R&DTI available to large companies which incur other expenditure in Australia. This includes expenditure on manufacturing in Australia, providing a perverse incentive for these companies to either reduce their manufacturing here (so their R&D expenditure has a higher weighting) or to move their R&D activity overseas.

These amendments are being proposed at a time when the Australian Government's support for Australian R&D through all programs, including through the R&D Tax Incentive, has fallen from 0.67% of GDP in 2011-12 to 0.48% of GDP in 2019-20.[3] While Australia's R&D is falling, the OECD is reporting an average real increase in Government expenditure on R&D of 2.1% in 2018.[4]

Most of the amendments in the current Bill were the subject of the Senate Committee Inquiry in 2018/19. In a bipartisan report, that Senate Committee rejected these amendments, saying they need to be reconsidered and the issues raised by the Committee needed to be addressed. These issues have not been addressed in the current Bill, and the modelling that has been provided is opaque and questionable. The Senate has been ignored and should reject the Bill for the same reasons it did last time.

We call on the members of the Senate Economics Legislation Committee to recommend the Senate oppose the passage of the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill* 2019. Further arguments and evidence are provided in the separate submissions of several of this submission's signatories.

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[3] Australian Government, Science, Research and Innovation (SRI) Budget Tables, 2019-20, Australian Government investment in R&D by sector and sub-sector, and other analyses Table 6, Australian Government investment in R&D as a percentage of Gross Domestic Product https://www.industry.gov.au/data-and-publications/science-research-and-innovation-sri-budget-tables

[4] OECD, 2020, R&D Budget Trends, http://www.oecd.org/sti/msti.htm, accessed on 2 March 2020